FOR MYSORE STATE

Secrt. II-27—100,000—22-5-48.

FINANCE (1948) Department.

7b SERIES.

G.O. No. 5 '17

Dated 11. 2. 1948

P 20
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[Despatch Abstract.]

Draft constitution - Income tax Exem
of Trading concerns of Provincial Govts f
payment of - Constituent Assembly and the
Govt of India Addressed — papers recorded

Finance Department.

Letter No. 3575 /3 G1 dated 20-1-48

To

The Secretary,
Constituent Assembly of India.
New Delhi.

Sir,

According to a report that appeared in the 'Hindu' dated the 24th December 1947, the Hon'ble the Finance Minister, Government of India, said, in the course of a speech at a meeting of the Southern India Chamber of Commerce at Madras on the 23rd December 1947, that he had suggested to the Expert Committee that had been set up to advise on the financial part of the new Constitution that a provision should be embodied in the new Constitution, ~~that a provision should be embodied~~ under which, when any Provincial Government undertook any trading or business enterprise, it should pay to the Central Government the same Income-tax and Corporation Tax as would be payable by any private party running the enterprise.

2. The scope of the proposal made by the Government of India is not clear. The Madras Government would be glad to have full details of the proposal as early as possible. In particular, they wish to know whether the proposal is intended to apply to all commercial and quasi-commercial concerns and departments of Provincial Governments including their Irrigation and Electricity Projects. They would also like to know whether it is intended to apply to the State Trading Schemes relating to purchase and sale of food grains, seed, manure, agricultural implements and other essential commodities that have been undertaken by Provincial Governments under emergency conditions with a view to mitigating the hardships arising from shortages in supply. These state trading schemes are not intended to run at a profit and taken as a whole, they involve heavy losses on account of subsidies. It would seem reason-

reasonable for the Provincial Governments to ask for the net losses on these schemes to be set off against any net profit on other commercial schemes run by them,.

3. The Madras Government consider that it would be quite unjustifiable to apply the proposal under consideration only to commercial and quasi-commercial concerns of the Provincial Governments and not to those of the Central Government. They presume that the receipts from the income-tax and the Corporation tax will be distributed between the Centre and the Provincial Governments under the new Constitution . If Government commercial and quasi-commercial concerns are to be made subject to these taxes, this should clearly apply to Central Government enterprises such as the Railways and the Post and Telegraphs Department as well as to Provincial Government enterprises. All the Governments concerned would then be pressed by public opinion to adjust the charges made by these concerns to consumers so as to avoid as far as possible, the emergence of any taxable profit. The additional work involved in making assessments would probably not produce much additional revenue, and all the Governments concerned would largely lose the possibility of improving their revenues by running commercial enterprises efficiently.

4. I am to request you kindly to communicate the provisional views of the Madras Government in the matter, as expressed above, to the President of the Expert Committee for allocation of finances between the Centre and the Provinces under the new Constitution, and to the Government of India, Ministry of Finance. I am also to request that full details of the proposal made by the Government of India be kindly sent to the Madras Government immediately, so that they may offer their considered views on this very important matter

P.T.O

Copy to the President of the Committee for allocation of finances, c/o Constituent Assembly, New Delhi.

Finance Department.

Letter No. 3575 B,G.[2] Dated 21-1-48.

To

The Secretary to the Government of India,
Ministry of Finance,
New Delhi.

Sir,

According to a report that appeared in the 'Hindu(' dated the 24th December 1947, the Hon'ble the Finance Minister, Government of India, said, in the course of a speech at a meetin of the Southern India Chamber of Commerce at Madras on the 23rd December 1947, that he had suggested to the Expert Committ that had been set up to advise on the financial part of the new Constitution, that a provision should be embodied in the new Constitution under which, when any Provincial Government undertook any trading or business enterprise, it should pa to the Central Government the same Income-tax and Corporation Tax as would be payable by any private party running the enter prise.

2. The scope of the proposal made by the Government of India is not clear. The Madras Government would be glad to have full details of the proposal as early as possible. In particular, they wish to know whether the proposal is intended to apply to all commercial and quasi-commercial concerns departments of Provincial Governments including their Irrigation and Electricity Projects. They would also like to know whether it is intended to apply to the State Trading Schemes relating to purchase and sale of food grains, seed manure, agricultural implements and other essential commodities that have been undertaken by Provincial Governments under emergency conditions with a view to mitigating the hardships arising from shortages in supply. These State Trading Schemes are not intended to run at a profit and, taken as a whole, they involve heavy losses on account of subsidies. It would seem reasonable for the Provincial Gov ments to ask for the net losses on these schemes to be set against any net profit on other commercial schemes run by

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run by them.

3. The Madras Government consider that it would be quite unjustifiable to apply the proposal under consideration only to commercial and quasi-commercial concerns of the provincial Governments and not to those of the Central Govt. They presume that the receipts from the income-tax and the Corporation tax will be distributed between the Centre and the Provincial Governments under the new Constitution. If Government commercial and quasi-commercial concerns are to be made subject to these taxes, this should clearly apply to Central Government enterprises such as the Railways and Post and Telegraphs Department as well as to Provincial Government entrprises. All the Governments concerned would then be pressed by public opinion to adjust the charges made by these concerns to consumers so as to avoid, as far as possible, the emergence of any taxable profit. The additional work involved in making assessments would probably not produce much additional revenue, and all the Governments concerned would largely lose the possibility of improving their revenues by running commercial enterprises efficiently.

4. I am directed to inform you that the Secretary to the Constituent Assembly of India has been requested to communicate the provisional views of the Madras Government in the matter, as expressed above, to the President of the expert Committee for allocation of finances between the Cent and the Provinces under the new Constitution, and to the Government of India, Ministry of Finance. I am to request that full details of the proposal made by the Government of India be kindly sent to the Madras Government immediately so that they may offer their considered views on this very important matter.

Y.O.S.

Copy to.....

P.T.O.

Copy to Secretary to Government,
Finance Department, Bombay.
" to Secretary to Government,
Finance Department, C.P.
" to Secretary to Government
Finance Department, West Bengal.
" to Secretary to Government,
Finance Department,East Panjab.
" to Secretary to Government,
Finance Department, U.P.
" Eo Secretary to Government,
Finance Department, Assam.
" to Secretary to Government,
Finance Department,Bihar.
" to Secretary to Government,
Finance Department,Orissa.

/True copy/

N.G.21.5.

SUPERINTENDEDNT,
Madras Record Office.

25/5.

No. 7125/33-D

Finance Department,
Bombay Castle. 21st January 1948.

From

B. VENKATAPPAIH, ESQUIRE, I.C.S,
Secretary to the Government of Bombay,
Finance Department.

To

M.V. Rangachari, Esquire,
Secretary to the Expert Committee on Finance
Ministry of Finance,
Government of India, New Delhi.

Subject:- Income-tax:
Liability of Provincial Governments to--

Sir,

The attention of the Government of Bombay has been drawn to the Press reports of Mr. Shanmukham Chetty's address to the South Indian Chamber of Commerce, Madras, wherein the Finance Minister is reported to have revealed that he had suggested to your Committee that, when any Provincial Government took up a trading activity, it should pay to the Central Government income-tax and other taxes in the same manner as a company or a private individual now pays these taxes. The Government of Bombay notes that this suggestion goes beyond the provisions of Section 155 of the Government of India Act, 1935, whereunder the Provincial Governments are not required to pay tax on their incomes, provided that such incomes are derived from activities restricted to their respective territories. From the provincial point of view, even the present position is not satisfactory and representations were made to the Government of India, by the Provincial Governments in 1945-46, e.g. by the Governments of the North West Frontier, Madras, the United Provinces , Bihar and Orissa, urging the repeal of proviso (a) to section 155 (1) of the Government of India Act, 1935. This Government did not represent at that time as it was advised that, despite the provisions of section 155 of the Government of India Act, the Central Govt. could not make even those incomes of Provincial Governments which were derived from an extension of their trading activities beyond their own territories chargeable to ~~income-~~

cont.

income-tax without first amending the Income-tax Act, and that the proper time for any representation would be when and if the Central Government brought in proposals to amend the Income-Tax Act so as to make such incomes of Provincial Governments chargeable to income-tax. Thus, while this Government along with other Provincial Governments has been opposed to the existing proviso (a) to section 155 (1) of the Government of India Act, 1935, the recently reported suggestion of the Finance Minister or the Government of India goes farther than even that proviso and seeks to tax all trading incomes of Provincial Governments, irrespective of whether the trading is restricted to or extends beyond the territory of the particular Province. The Government of Bombay desires to express its emphatic opposition to any such suggestion and to reiterate its agreement with the representation previously made by certain Provinces regarding the desirability of deleting proviso (a) to Section 155 (1).

3. The suggestion reported to have been made by the Finance Minister appears to have been ~~made by the Finance~~ based on the following assumptions:

(i) that if taxes on a private company are a proper payment, they are no less proper charges against Government undertakings; and

(ii) that the exemption from tax of Government undertakings involves considerable loss to the Central revenues.

As regards the first assumption, it need only be pointed out that it is directly in contravention of the policy of nationalisation and that to act upon it would be to give definite discouragement to the process of nationalisation which has already been initiated and is progressing in several Provinces. In regard to the second assumption, it may be pointed out that unless the Provincial Governments are allowed to appropriate the full income from their public

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~~public~~ utility undertakings, without a share of it being taken away by the Central Government through taxation, there will be no materail financial gain to the Provinces from embarking on a policy of nationalisation of public utility and other concerns. and to that extent there will be increased Central liability in the matter of subsidising the Province.

4. It may furtner be noted that the Central Government for its part, enjoys exemption from provincial measures of taxation such as the motor vehicles tax, electricity duty, and the urban immovable property tax. The policy of exemption has thus been a mutual one.

5. For the reasons specified above, the Government of Bombay feels that instead of withdrawing the exemption granted at present to Provincial Governments under Section 155 of the Government of India Act, 1935, there is a strong case for liberalising it by repeal of proviso (a) of that section.

Your obedient servant,

Sd.....
Secretary to the Government of Bombay
Finance Department.

Copy to-
The Secretary to the Ministry of Finance,
Government of India.

/True copy/

SUPERINTENDENT,
Madras Record Office.

N.G.22.5.

25/5

No. CA/003/Cons/47.
CONSTITUENT ASSEMBLY OF INDIA.

Council House.

New Delhi, the 6th February 1948.

To

The Secretary to the Govt. of Madras,
Finance Department,
Madras.

SUBJECT: PAYMENT OF INCOME TAX AND CORPORATION TAX ON TRADING AND BUSINESS ENTERPRISES RUN BY PROVINCIAL GOVERNMENTS.

.....

Dear Sir,

With reference to your letter No.3373-DG-1 dated the 20th January 1948 on the subject noted above I am directed to enclose a copy of the Report of the Expert Committee on the Financial Provisions of the Union Constitution, paragraphs 73 and 74 of which set out the full details of the proposal in question. I am to add that the provisional views of the Madras Government in the matter as explained in your letter will be brought to the notice of the drafting Committee who are considering the report of the Expert Committee.

It is requested that the report is to be treated as confidential until formally presented to the Constituent Assembly of India.

Yours truly,

Sd.....
(S.N. Mukerjee)
Joint Secretary.

/True copy/

N.G.22.5.

SUPERINTENDENT,
Madras Record Office.

VR
25/5

No.B-549/X-147A/45.

From

P.A. Gopalakrishnan, Esqr., I.C.S.,
Secretary to Government,
United Provinces.

To

Secretary to the Government of India,
Ministry of Finance,
New Delhi.

FINANCE DEPARTMENT Dated Lucknow, February 23, 1948.

SUBJECT:- Income-tax - Liability of Provincial Government to

Sir,

The attention of the Government of the United Provinces has been drawn to the Press reports on the speech of the Hon'ble the Finance Minister, Government of India, to the South Indian Chamber of Commerce at Madras on 23rd December, 1947, in which he is reported to have stated that he had suggested to the Expert Committee that had been set up to advise on the financial part of the new constitution, that a provision should be embodied in the new Constitution under which, when any Provincial Government undertook any trading or business enterprise, it should pay to the Central Government the same Income-tax and Corporation Tax as would be payable by any private party running the enterprise. Also according to a report which appeared in the 'pioneer dated February 10, 1948. the Hon'ble Finance Minister in the course of his speech in the Constitutent Assembly (Legislativ on February 9th last expressed the hope that when constitution making was taken up by the Constituent Assembly, an appropriate step would be taken to see that the railways and all other similar state owned and mangged concerns were placed under an obligation to pay to central revenues an amount equivalent to income-tax and corporation tax.

2. The Provincial Government are not aware of any proposal on the above subject but the reported suggestion, if accepted, would undoubtedly have far reaching effect prejudicial to the national economy of the Province.

cont.

It is not known whether the intention is to tax all commercial and quasi commercial concerns and departments of the Provincial Government including their Irrigation, Electricity and Road Transport Schemes, which are either in the making or have already been launched as a first stride towards the objective of nationalisation of industries. Also the imposition of any tax on State Trading Schemes relating to the purchase and sale of food grains, seed, manure agriculatural implements and other essential commodities which have been undertaken by the Provincial Government under emergency conditions with a view to mitigating the hardship arising from the shortage in supply would hamper such beneficent activities. The suggestion go beyond the provisions of section 155 of the Government of India Act, 1935, under which the Provincial Governments are not required to pay any tax on their incomes derived from activities restricted to their respective territories. Even the present Position under the Act is not satisfactory and this Government have already expressed their view on the question of the repeal of proviso (a) to Section 155(2) of the Act in their letter No.B-1096/X-147A-1945 dated May 30, 1947 and urged that exemption from income-tax should be allowed in cases of public utility undertakings to which the above proviso would apply.

3. This Government considers that it would be absolutely wrong in principle to impose income-tax and corporation tax on any trading or business undertaking controlled and managed by a Provincial Government. The Government of India undoubtedly stands for nationalisation of key industries and public utilities which is also the objective of the Provincial Government according to the oft declared policy of the Indian National Congress. We feel that any such measure as suggested in the Hon'ble Finance Minister's Speeches is sure to hamper and retard progress towards nationalisation. The taxation of Public utility concerns run by the State - either through the

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through the Central or a Provincial Government - would be a retrograde if not a hazardous step. The United Provinces Government hope that no such proposal is under consideration and earnestly urge that it should, in any case, be dropped. All nation building activities have to be conducted and financed by Provincial Governments, and the proposed taxation will reduce the available and even the best of Schemes can have no chance. This Government trust that no action will be taken by the Government of India which will make their havey task still more difficult.

I have the honour to be,

Sir,
Your most obedient servant.

(P.A?,GOPALAKRISHNAN)
S E C R E T A R Y.

‡ True copy.

N.G,22.5.

SUPERINTENDENT,
Madras Record Office

BR
25/5-

Government of Orissa,

Finance Department.

No. 3948 (3) F.

From

Rao Bahadur N.M. Mahanti, B.A.,
Additional Secretary to Government.

To

The Secretary to the Government of Madras
" Bombay
" United Provinces.

Finance Department.

Dated, Cuttack, the 6th May 1948.

Subject:- Liability of Provincial Governments to pay Income-tax.

.....

Sir,

I am directed to acknowledge with thanks the receipt of a copy of your letter No. 3575 B.G-2 dated 21st January 1948, 7125/33-D dated 21-st January 1948, and B349/X-147A/45 dated 23rd February 1948 and to forward, for the information of the Government of Madras/Bombay/ the United Provinces a copy of letter No.3942F dated the 6th May 1948 addressed to the Government of India in the Ministry of Finance.

I have the honour to be,

Sir,

Your most obedient servant,

Sd.....
Additional Secretary to Govt.

Finance (B.G)

submitted for perusal. May be lodged and filed.

/True copy/

N.G.22.5.

SUPERINTENDENT,
Madras Record Office.

GOVERNMENT OF ORISSA
Finance Department.

No. 3942 /F

From

The Chief Secretary to Government.

To

The Secretary to the Government of India,
Ministry of Finance,
NEW DELHI.

dated Cuttack, the 6th May 1948.

Subject:- Liability of Provincial Governments to pay income-tax.

Sir,

I am directed to refer to letter No. 3575 B.G-2 dated the 21st January 1948 from the Government of Madras, letter No. 7125/33 D, dated the 21st January 1948 from the Government of Bombay and letter No. 6549/x 1493/45 dated 23rd/24th February 1948 from the Government of the United Provinces to your address, copies of which have been received from the Provincial Governments concerned, and to say that the Government of Orissa fully associate themselves with the suggestions and recommendations which the Governments of Bombay, Madras and the United Provinces have made. Orissa was one of those provinces which previously pressed for the repeal of proviso (a) to Section 155 of the Government of India Act, 1935. Though in Mr. Rangachari's letter No.F.3 (14) -B/46 dated the 30th July 1946 the Government of India did not agree with the Provincial Government that acceptance of the liability to Central taxation under section 155 of the Government of India ACt was bound to Act as a deterrent to Provincial Governments undertaking joint schemes of development, the Government of Orissa had hoped that it would in due course be realised that the provision referred to was unlikely to fetch any appreciable revenue to the general Exchequer and that it would be repealed with a view to remove a source of unnecessary irritation. Recent events have, however, belied this hope. The indications are that

cont.

that not only would the provision adverted to above be retained in the new Constitution but its scope would be greatly widened so as to make the income of a Provincial Government from trade or business liable to Union Taxation, whether the trade or business is carried on inside or outside the Province. It appears that the measure of financial reform of which the Hon'ble the Finance Minister of the Govt. of India gave an indication in his speech at Madras on the 23rd December 1947 (and against which protests have been lodged by the Governments of Bombay, Madras and the United Provinces) has since been embodied in a definite provision (Article 266) of the draft Constitution of India, which provides that where a trade or business of any kind is carried on by or on behalf of a State, the Government of that State shall not be exempted from any Union tax or levy or sum in lie of such tax in respect of such trade or business or any operation connected therewith or any income arising in connection therewith or any property occupied for the purpose thereof. The Provincial Government submitted below some of the reasons for which, in their view, the provision is open to grave objections.

(1) The Government of Orissa would suggest that it would be entirely incorrect to proceed on the assumption that a Provincial Government which undertakes trading activities stands on the same footing as a private business man. No Government can afford to make undue profits from its trading activities and no Government would dream of hoarding profits like private persons. Whatever profits a Government may make from any trade or business undertaken by them would merely go to augment their revenues which must always be wholly spent for the benefit of the people. It is hard to see , in these circumstances, any moral justification for taxing the income of Provincial Governments from any source.

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(2) If it is the intention that the authorities of the Income Tax Department will treat the income of Provincial Governments from trade or business in the same way as the income of business men is treated the Provincial Government suggest that the arrangement eventually lead to embitterment of feelings between the Union and the State Governments. The explanation given below Article 266 that operations incidental to the ordinary functions of the Govt. of a State shall not be deemed to be trade or business is not likely to improve matters, since disputes are bound to occur on such questions as whether a particular state activity like an Irrigation or an Electrical undertaking is or is not an ordinary function of Government Disputes will also arise on such points as whether all activities of the Provincial Government should be taken together for the purpose of assessment or whether the income from each undertaking should be assessed separately. It would hardly make for cordial relations between the Union and its component parts if such disputes were to form the subject matter of litigation and arbitration by the Supreme Court.

(3) If it is the case that the provision in Article 266 of the draft Constitution has been made in view of the fact that the modern tendency is towards nationalisation of industries, the Provincial Government would submit that while it is true that nationalisation might result in the loss of income tax revenue to the Central Government, the loss will also be shared by the State Governments to the extent that they would be allowed a portion of the revenue from this source, The Provincial Government notice that the draft Constitution does not seek to provide for imposition of income tax on commercial activities of the Central Govt. for example, the administration of the State railways. The intention thus appears to be that where nationalisation will be undertaken directly by the Central Government, the loss of income tax consequent on it will be made good by the retentic of the profits which will accrue from the Central Government

cont.

trading activites; but that where nationalisation will be undertaken by the State Governments, the Central Government would safeguard themselves from any loss of revenue by assessing the profits of the State Governments to income tax at the usual rates. The Provincial Government venture to suggest that this arrangement would have the most undesirable effect that the Provinces will look upon the Centre not as a superior authority which would make the welfare of the Provinces its particular care but as a separate and interested party which would grudge to see the provinces in a better financial position. An equitable distribution of revenues so as to place larger funds at the disposals of the Provincial Governments and give them greater liberty to spend the money for the benefit of the provincies has been the past policy of the Government of India for many decades. The proposed measure which is now under contemplation will in a way be a complete reversal of that policy and will, as the Government of United Provinces have pointed out, be a most retrograde and hazardous step Nobody can foretell the consequences that will follow in the wake this new policy. It may well be that if ultimately income tax is imposed on trading activities of Provinces, the Provincial consumer will press their Governments to reduce their charges for the services rendered so as to bring the net profits below the taxable limit; if the Provincial Governments yield to such pressure, as they may well have to, the result will be that neither the Central nor the Provincial revenues will secure any benefit from the trading activities undertaken by the State Governments.

(4) The Government of Orissa would submit that in essence the problem really is one of inancial adjustment between the Centre and the Provinces. They suggest that since an equilibrium between the Central and

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the Provincial revenues has still not been attained, Provinces might well be left to develop their resources their own way free from such Central financial control as the Central Govt. may consider it expedient to place on the accumulation of private capital. If it transpires at any time in future that the trading activities of the Provincial Governments are jeopardising the financial stability of the Union, the proper course to adopt would be some sort of adjustment whether by way of contributions by the Provinces to the Centre as was done under the Meston Award, or in some other suitable way. The power to make such adjustments may quite appropriately be taken under the new constituent for India to the length of immediately imposing the Central tax on the income derived by Provincial Governments on its trading activities or business enterprises would come. In the Provincial Government's view, dangerously near an openl admission that the interests of the Provinc and of the Union are antagonistic. It would be most unfortunate if any such feeling were allowed to prevail as its practical consequence is bound to be growth of provincialism and a diminution of the sense of national solidarity which all authorities Central and Provincial are at the moment anxious to foster.

2. The Government of Orissa hope that the Government of India will duly take into account the submission which they have made above and take steps for a revision of Article 266 of the draft Constitution of India. The Provincial Government do not think it right that AArticle 266 should in any circumstances go beyond proviso (a) to section 155(1) of the Government of India Act, 1935, and in fact they would prefer, as they had previously recommended in their letter No.1.F, dated the 17th April 1946, that even the present proviso to section 155(1) should be deleted altogether in the new Constitution.

3. ~~A copy of this letter is being sent to the Secretary to the Constituent Assembly of India for the information of the Assembly.~~

p.t.o.

(3) A copy of this letter is being sent to the Secretary to the Constituent Assembly of India for the information of the Assembly.

I have the honour to be,

Sir ,

Your most obedient servant,

Sd.....
for Chief Secretary to Government.

/True copy/

N.G.22.5.

SUPERINTENDENT
Madras Record Office.

The papers may be recorded in a G.O. for facility of future reference.

G.O. Ms No. 574 Fin. dated 11-6-1948.

Recorded.

Abstract

Draft constitution - Income tax Exemption of trading concerns of provincial Governments from payment of Constituent Assembly and its Govt. of India addressed - papers recorded.